ALLIED FARM EQUIPMENT, INC. ANNUAL REPORT 1975

Allied's Operating Division General Managers,
(left to right)
William Cockshutt, J.R. Findlater,
Robert Blinn, J.L.S. Ross, C.M. Baker, I. L. Wood.

Allied in 1976:

STRATEGICALLY POSITIONED IN AN EXPANDING MARKETPLACE

With national and world food demands continuing to increase, making North American farm mechanization needs ever more vital, Allied has entered 1976 — its 30th year — in the strongest strategic position in its history.

Essentially, Allied has strengthened its place as North America's largest wholesale distribution organization for specialty farm equipment and the only such organization covering the continent coast to coast. The company also made significant improvement in its role as a manufacturer of its own ALLIED branded lines of specialty equipment.

Because this position is unique within the industry, it is difficult to classify Allied in a blanket manner within the familiar category of Agricultural Equipment which commonly signifies either the "Big Seven" tractor producers or the wide range of specialty equipment manufacturers across the country. It is the uniqueness of Allied's strategic posture in the distribution field plus its manufacturing mix that has helped the company to outpace most of the industry in terms of financial performance (during the past 10 years Allied's sales and earnings have nearly tripled).

A keystone of Allied's distributor role is the fact that many manufacturers of specialty farm implements continue to find it more economical to allocate sales territories to a warehouse distribution company on an exclusive basis. In potential volume and variety of products that may be sold to a retailer in one sales call, the professional distribution organization can offer a clear economic advantage. As the largest of these, Allied today covers 29 key U.S. farming states and all of Canada with a network of 17 warehouse distribution centers. These are staffed by a sales force of more than 100 experienced farm implement marketing professionals. This force is in regular personal contact with about 5000 farm equipment dealers in North America, plus numerous other dealers specializing in recreational products and industrial equipment. To this market, Allied provides sales and warehousing services for more than 70 specialty farm implement lines. Rather than competing with the well known tractor/combine producers, Allied products generally are complementary to these lines and embrace the broad range of support equipment that has become increasingly essential to farm mechanization, labor saving efficiencies and greater crop yield productivity. Those lines marketed by Allied under a franchise arrangement with other manufacturers include materials handling equipment, tillage equipment, harvesting equipment, hay, forage and feed preparation equipment, agricultural hydraulics, small tractors, earth moving equipment, orchard equipment, leisure products and other miscellaneous products. ALLIED brand name products, manufactured at three production facilities in the Winnipeg Manitoba area, include tractor mounted hydraulic loaders, grain augers, bale elevators and conveyors, harrow equipment, agricultural hydraulic equipment.

Allied's Corporate Management
(left to right)
Sol Kanter, John J. Jeffers, James I. Kanter, Carl E. McNair, A.J. Kanter, Daniel Z. Tropp, Dennis W. Samman.

James I. Kanter, President

Fellow Shareholder:

Our annual report last year concluded by stating "While the disappearance of shortages undoubtedly will mean that marketing capabilities will be more fully tested, we are confident that Allied is sufficiently prepared. We fully intend to win an increasing share of what appears to be a continuing strong market."

Allied did encounter more competitive market conditions in 1975, and yet accomplished what it had set out to do. Sales rose 16.3% to reach a new record high for the third consecutive year. Earnings continued to increase faster than sales, with net earnings before extraordinary items rising 32.6% to a new all time high.

Also of significance, Allied in 1975:

- Initiated negotiations with our holder of convertible preferred stock, culminating in January, 1976 in an agreement that substantially reduces our potential for future common equity dilution.
- Obtained franchise distribution rights for 5 additional lines of specialty farm implements and acquired new territorial franchises from 9 existing suppliers.
- Introduced 4 new models of ALLIED branded equipment.

OPERATING RESULTS:

In the fiscal year ended October 31, 1975 sales rose to a record $44,660,000 from $38,412,000 in the prior year. Earnings before taxes and extraordinary items totaled $3,193,000, up 50% from $2,122,000 in 1974. Due to Canadian tax differences, and unrealized foreign currency translation loss not deductible for income taxes, income taxes rose to almost double the prior year amount. Despite that factor, net income before extraordinary items reached a record $1,509,000 or $1.29 per share ($.79 fully diluted) as compared with $1,138,000 or $1.05 per share ($.64 fully diluted) in 1974. Primary per share earnings are based on an average of 1,115,966 common and common share equivalents outstanding in 1975, an amount 11% higher than the 1974 figures. In 1974 the company also reported approximately items of $630,000, primarily related to tax loss carryforward credits, which brought total net income for that year to $1,768,000 or $1.68 per share ($.98 fully diluted).

Much of our increased profitability was due to our continuing plan of greater *put-through* of sales volume across our existing distribution network with its substantially fixed overhead. This greater put-through was achieved by more aggressive selling efforts by our field staff, more effective sales promotion, additional lines we have added, and higher sales prices and increased unit sales. Resulting from the success of this plan, our gross profit margin rose to 26.3% from 25.3%; and our operating profit margin, before interest expense, rose to 10.9% of sales in 1975, as compared with 9.5% in 1974, 8.6% in 1973, 6.5% in 1972 and 4.6% in 1971. We maintained a satisfactory level of inventory turnover, at 2.1X, as compared with 2.3X in 1974, 2.1X in 1973, and lesser turnover in prior years. Other contributing factors to the profitability were:

- A higher volume of sales per salesman, which reached $784,711 in 1975, as compared with $650,847 in 1974 and $518,644 in 1973.
- Maintaining a favorable ratio of receivables turnover, which equaled 4.8X, as compared with 4.4X in 1974 and 3.1X in 1973.
- Further reduction in selling and administrative costs as a per cent of sales, which was reduced in 1975 to 15.4% as compared with 15.8% in 1974, 17.2% in 1973.
- A reduction in interest costs as a per cent of sales. This ratio dropped to 3.8% in 1975, vs. 4.0% in 1974 and 4.4% in 1973.

FINANCIAL POSITION:

As of our October 31 year end, net working capital totaled $9,443,000 as compared with $8,903,000 at the prior year end. Current ratio equaled 1.50 to 1 as compared with 1.63 to 1 a year earlier.

Assets totaled $30,540,000, up significantly from $24,668,000 in the prior year. Liabilities at year end were just over $22.2 million as compared with $17.8 million at the prior year end. Of these, $3,328,000 represented long term debt. Shareholder equity at year end totaled $8,293,000, or $6.84 per common share, a significant gain from $6,866,000 or $5.41 per share a year earlier.

MANUFACTURING

During 1975 an additional 22,000 sq. ft. was added to our manufacturing facility at St. Boniface near Winnipeg. The addition brings our total manufacturing space in the Winni-

peg area to 144,000 sq. ft. Also noteworthy was the installation of an IBM computer system that is adding substantial efficiencies to our production control, scheduling and inventory analysis.

HUMAN RESOURCES

1975 saw the need for numerous key executive appointments, including the promotion of several talented and deserving executives to higher positions. Among these were: D. W. Samman as Assistant to the President; J. R. Findlater was named General Manager of our Alberta/British Columbia Division; I. L. Wood as General Manager of our Manitoba/Saskatchewan Division; Eldon Mogg, Sales Manager for agricultural equipment at the Manitoba/Saskatchewan Division; Howard Stevens, General Sales Manager of our Western Division; Dale Faith, General Sales Manager of our Eastern Division.

A major step forward in our R&D staffing in 1975 was the appointment of Roger L. Patterson as Engineering Manager at our manufacturing facilities. He will devote the majority of his time to the supervision of ALLIED brand product improvement and new product research.

Early in 1975 we had the pleasure to announce that three widely respected individuals had been elected to Allied's Board of Directors. They are Russell Baker, Senior Partner of Baker & McKenzie, Chicago, an international law firm; Robert D. Kelly, Vice President of A. T. Kearney & Co., Chicago, a major management consulting firm; and Ronald H. Shiftan, a Corporate Finance Officer in the investment banking firm of Bear, Stearns & Co., New York City. We also convey our deepest gratitude to three individuals who retired from Allied's Board of Directors in 1976 after many years of tireless and dedicated service: Samuel M. Kane, who remains as Secretary and Counsel to the company, Solomon Kanter, who remains a Vice President of Allied and John S. Malmgren, President of Excel Manufacturing Ltd.

REFINANCING

Recently we completed a refinancing with IU Investment Corporation, Philadelphia, the holder of Allied's preferred stock. Prior to such refinancing IU held 15,000 shares ($1.5 million par value) of Allied's Series A and B convertible preferred stock. Of those shares, Series A may be converted into common shares at $3.00 per share before November 1, 1976 and at $2.00 per share thereafter. Series B shares may be converted into common shares at $2.00 per share after November 1, 1978.

On January 23, 1976, Allied consummated a stock repurchase transaction with IU whereby Allied repurchased 2,500 shares of the Series A preferred stock and all of the Series B preferred stock for $750,000. In connection with this transaction IU agreed to Allied's deferral of $540,000 of existing indebtedness to IU, to be paid by Allied over the next three years. Further, Allied and Teachers Insurance and Annuity Association of America modified certain terms of their existing loan agreements, which modifications included Allied's undertaking to make a prepayment of $23,750 per year during each of the next four years on such existing loans.

This transaction eliminated the potential dilution of 375,000 common shares of Allied or about 38% of the total potential dilution previously represented by the preferred stock and other securities. This dilution reduction should work to the substantial benefit of all common shareholders.

CURRENT OUTLOOK

Allied continues to believe that the farm equipment industry has shed many of its traditionally cyclical characteristics that were present in the 1950's and the 1960's. This belief is based on the growing world food shortage that has placed higher priorities on food production, especially in the North American bread basket. World wide grain demand is projected to rise from about 1.3 billion metric tons annually in the 1969-71 period to almost 1.8 billion tons by 1985. (Also, meat and poultry demand is expected to rise from 105 million tons to more than 170 million tons in that same period.)

Even against this favorable outlook, with its buoyant effect on farmer's purchasing power, the highly competitive characteristics of the farm equipment industry, present in 1975, are likely to continue unabated in 1976. Nevertheless, Allied's capacity to meet that competition is now stronger than ever before in its history and we expect to continue to obtain a larger share of the market. Based on these expectations, and the consequent profitability benefits that can accrue from an even larger volume put-through in our existing structure, we are optimistic for a continuation of record results.

Sincerely,

James I. Kanter

James I. Kanter
President

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE PROFILE OF FINANCIAL DATA

1975 compared to 1974:

During 1975 net sales and gross profits increased by $6,240,000 and $2,035,000, respectively, over 1974 primarily as a result of higher sales prices and increased unit sales. During 1975 the Company's gross profit margin increased by 1% over 1974.

In 1975 the effective income tax rate was greater than the normal tax rate primarily as a result of unrealized foreign currency translation losses not deductible for income tax purposes and foreign income tax differences.

In 1975 the Company had no extraordinary items primarily due to the non-recurring nature of these items.

1974 compared to 1973:

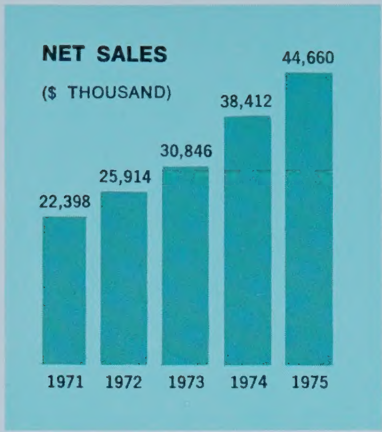
In 1974 the increase over 1973 in net sales and gross profits resulted from the pass-through of higher product costs and from increased unit sales due to bouyant farm economic conditions. In 1973 the increase in net sales and gross profits reflected principally increasd unit sales. During 1974 the Company's gross profit margin declined by 4/10 of 1%, whereas in 1973 it had increased by 1%.

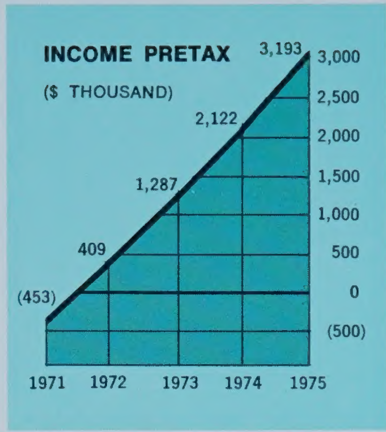
The increased interest expense incurred by the Company during 1974 reflects higher market interest rates. In 1973 the increased interest cost resulted from higher loan levels.

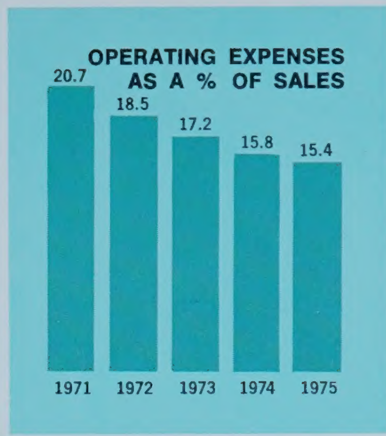
In 1974 the effective income tax rate was less than the normal tax rate primarily as a result of unrealized foreign currency translation gains not subject to income tax. In 1973 the effective income tax rate was greater than the normal tax rate due to the non-deductibility of unrealized foreign currency translation losses and the status of Canadian withholding taxes which were not allowable as a tax credit in the United States.

In 1974 the Company's extraordinary items increased primarily due to increases in benefits attributable to prior years' losses carried forward and foreign tax credits. In 1973 the extraordinary items increased significantly from the prior year due to increases in benefits attributable to prior years' losses carried forward.

Profile of Financial Data







THOUSANDS OF DOLLARS (except per share figures)

OPERATING RESULTS	1975	1974	1973	1972	1971	1970	1969	1968	1967	1966
Net Sales	$ 44,660	$ 38,412	$ 30,846	$ 25,914	$ 22,398	$ 24,420	$ 29,009	$22,534	$19,959	$16,393
Gross Profit	32,909	9,716	7,930	6,397	5,636	6,113	7,414	5,829	5,480	4,792
Selling, general and administrative expenses	6,880	6,083	5,297	4,782	4,631	5,860	6,102	4,307	3,771	3,263
Gain on repurchase of debentures	(1)	(33)	(21)	(64)	(33)					
Interest Expense	1,679	1,544	1,367	1,270	1,491	1,594	1,299	872	668	464
Income pretax	3,193	2,122	1,287	409	(453)	(1,342)	13	650	1,041	1,065
Net income before extraordinary items	1,509	1,138	534	267	(525)	(1,199)	(109)	333	523	575
Per common share assuming no dilution	1.42	1.05	.45	.20*	(.52)	(1.21)	(.11)	.34	.53	.64
Extraordinary items	—	630	396	(57)	63		47			
Per common share assuming no dilution	—	.63	.40	(.06)	.06		.05			
Net income	1,509	1,768	930	210	(462)	(1,199)	71**	333	523	575
Per common share assuming no dilution	1.29	1.68	.85*	.14*	(.46)	(1.21)	.07	.34	.53	.64
Per common share assuming full dilution	.79	.98	.53	.12						
Shares Outstanding	993	993	993	992	992	992	992	992	992	992
YEAR END POSITION										
Current working capital	9,443	8,903	8,465	8,343	8,421	7,528	9,151	9,673	5,903	5,623
Current ratio	1.50	1.63	1.68	1.65	1.67	1.45	1.59	1.80	1.61	1.77
Total assets	30,540	24,668	22,239	22,762	22,704	26,493	27,235	24,282	17,586	15,050
Total Liabilities	22,247	17,802	17,059	18,431	18,594	23,377	22,920	20,036	13,668	11,562
Net Worth	8,293	6,866	5,180	4,261	4,110	3,116	4,315	4,247	3,918	3,487
Book value per common share	6.84	5.41	3.71	2.78	2.63	3.14	4.35	4.28	3.95	3.52
Number of employees	600	690	546	501	470	512	727	790	680	610
Number of shareholders	809	840	824	835	856	869	874	862	837	881

**After deduction of preferred dividends requirement.*

***Including $133,000 credit (.13 per common share) due to accounting change in method of valuing inventories to include certain costs previously expensed as incurred.*

STOCK AND DIVIDEND DATA

COMMON SHARES — BID QUOTATIONS — OTC

	FISCAL 1975 HIGH	FISCAL 1975 LOW	FISCAL 1974 HIGH	FISCAL 1974 LOW
1ST QUARTER	2	1	2½	2
2ND QUARTER	3¼	1½	3¼	2⅝
3RD QUARTER	3½	3¼	3¾	2¼
4TH QUARTER	3¾	3	2½	2

DIVIDENDS

A dividend of $1.375 per preferred share has been paid in each of the past eight quarters. No dividends have been paid on common shares.

STOCK LISTING INFORMATION:

The company's common shares are traded Over-the-Counter through the NASDAQ electronic quotation system with the trading symbol of ALFMA.

Accountants' Report

To the Board of Directors and Shareholders
Allied Farm Equipment, Inc., Chicago, Illinois

We have examined the consolidated balance sheet of Allied Farm Equipment, Inc. and Subsidiaries as of October 31, 1975 and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the consolidated financial statements of the Company and Subsidiaries for the year ended October 31, 1974. We did not examine the financial statements of Allied Farm Equipment, Inc., a Delaware corporation, a consolidated subsidiary, which statements reflect total assets and sales constituting 13% and 16%, respectively in 1975 and 14% and 19%, respectively in 1974 of the related consolidated totals. These statements were examined by other certified public accountants whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for such subsidiary is based solely upon the report of the other accountants.

In our opinion, based upon our examination and the report of the other accountants, the aforementioned financial statements present fairly the consolidated financial position of Allied Farm Equipment, Inc. and Subsidiaries at October 31, 1975 and 1974 and the consolidated results of their operations and of changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Also, we have reviewed the pro forma balance sheet as of October 31, 1975 and in our opinion, it presents fairly the consolidated financial position of Allied Farm Equipment, Inc. and Subsidiaries as it would have appeared at October 31, 1975 had the repurchase of preferred stock as described in Note 11 been consummated at that date.

Chicago, Illinois
January 23, 1976

COOPERS & LYBRAND

Consolidated Statements of Earnings

FOR THE YEARS ENDED OCTOBER 31, 1975 AND 1974

	1975	*1974*
Sales	$ 44,660,000	$ 38,412,000
Cost of sales (Note 2)	32,909,000	28,696,000
Gross Profit	11,751,000	9,716,000
Selling, general and administrative expenses	6,880,000	6,083,000
Interest expense	1,679,000	1,544,000
Gain on repurchase of 6% Convertible Subordinated Debentures	(1,000)	(33,000)
	8,558,000	7,594,000
Earnings before income taxes and extraordinary items	3,193,000	2,122,000
Income taxes (Notes 1 and 4):		
Current:		
United States	745,000	603,000
Canadian	984,000	369,000
	1,729,000	972,000
Deferred	(45,000)	12,000
	1,684,000	984,000
Earnings before extraordinary items	1,509,000	1,138,000
Extraordinary items (Note 9)	—	630,000
Net earnings	$ 1,509,000	$ 1,768,000
Earnings per common and common equivalent share (Note 10):		
Before extraordinary items	$ 1.29	$ 1.05
Extraordinary items	—	.63
Net earnings	$ 1.29	$ 1.68
Earnings per common share assuming full dilution (Note 10):		
Before extraordinary items	$ .79	$ .64
Extraordinary items	—	.34
Net earnings	$ .79	$ .98

Consolidated Statements of Retained Earnings

FOR THE YEARS ENDED OCTOBER 31, 1975 AND 1974

	1975	1974
Balance, beginning of year	$ 3,803,000	$ 2,117,000
Net earnings	1,509,000	1,768,000
Cash dividends on preferred shares	(82,000)	(82,000)
Balance, end of year	$ 5,230,000	$ 3,803,000

The accompanying notes are an integral part of the financial statements.

Consolidated Balance Sheets

OCTOBER 31, 1975 AND 1974

Assets

	Pro Forma 1975 (Note 11)	1975	1974
Current assets:			
Cash	$ 423,000	$ 632,000	$ 523,000
Receivables (Notes 3 and 5)	10,160,000	10,160,000	8,275,000
Less allowances for doubtful accounts	(307,000)	(307,000)	(306,000)
Inventories (Notes 1, 3 and 5)	17,604,000	17,604,000	13,583,000
Property held for resale (Note 8)	—	—	600,000
Other	267,000	267,000	304,000
Total current assets	28,147,000	28,356,000	22,979,000
Property, plant and equipment, at cost (Note 1):			
Land	230,000	230,000	230,000
Buildings	1,484,000	1,484,000	1,073,000
Machinery and equipment	2,624,000	2,624,000	2,227,000
	4,338,000	4,338,000	3,530,000
Less accumulated depreciation	2,272,000	2,272,000	2,024,000
	2,066,000	2,066,000	1,506,000
Other assets	118,000	118,000	183,000
	$ 30,331,000	$ 30,540,000	$ 24,668,000

Liabilities and Shareholders' Equity

	Pro Forma 1975 (Note 11)	1975	1974
Current liabilities:			
Notes payable, banks (Notes 3 and 5)	$ 4,579,000	$ 4,579,000	$ 2,681,000
Bankers' acceptances payable (Notes 3 and 5)	5,390,000	5,390,000	5,100,000
Current portion of long-term debt (Note 5)	931,000	837,000	781,000
Accounts payable	4,652,000	4,652,000	4,071,000
Accrued liabilities	1,832,000	1,832,000	1,076,000
United States and Canadian income taxes	1,623,000	1,623,000	367,000
Total current liabilities	19,007,000	18,913,000	14,076,000
Long-term debt (Note 5)	3,775,000	3,328,000	3,675,000
Deferred income taxes (Note 1)	6,000	6,000	51,000
Commitments and contingent liabilities (Note 8)			
Shareholders' equity (Notes 5 and 7):			
Capital stock:			
5½% cumulative convertible preferred stock:			
Series A, $100 par value; authorized, issued and outstanding, 10,000 shares	750,000	1,000,000	1,000,000
Series B, $100 par value; authorized, issued and outstanding, 5,000 shares	—	500,000	500,000
Class A common stock, $1 par value; 5,000,000 shares authorized, 993,069 shares in 1975 and 992,569 shares in 1974 issued and outstanding	993,000	993,000	993,000
Capital in excess of par value of common shares	570,000	570,000	570,000
Retained earnings	5,230,000	5,230,000	3,803,000
Total shareholders' equity	7,543,000	8,293,000	6,866,000
	$ 30,331,000	$ 30,540,000	$ 24,668,000

The accompanying notes are an integral part of the financial statements.

Consolidated Statements of Changes in Financial Position

FOR THE YEARS ENDED OCTOBER 31, 1975 AND 1974

	1975	1974
Sources of working capital:		
From operations:		
Earnings before extraordinary items	$ 1,509,000	$ 1,138,000
Items not requiring current outlay of funds:		
Depreciation	258,000	188,000
Amortization of financing costs	17,000	33,000
Noncurrent deferred income taxes	(45,000)	12,000
Working capital from operations before extraordinary items	1,739,000	1,371,000
Extraordinary items	——	630,000
Working capital from operations	1,739,000	2,001,000
Proceeds from mortgage loan	489,000	
Sale or retirement of property and equipment	2,000	113,000
Other, net	48,000	70,000
Total sources of working capital	2,278,000	2,184,000
Uses of working capital:		
Reduction of long-term debt	836,000	890,000
Investment in property, plant and equipment	820,000	774,000
Dividends on preferred shares	82,000	82,000
Total uses of working capital	1,738,000	1,746,000
Increase in working capital	$ 540,000	$ 438,000
Working capital at end of year (current assets less current liabilities)	$ 9,443,000	$ 8,903,000
Changes in components of working capital:		
Cash	$ 109,000	$ 16,000
Receivables	1,884,000	(800,000)
Inventories	4,021,000	2,149,000
Property held for resale	(600,000)	600,000
Other	(93,000)	94,000
Notes payable	(1,898,000)	3,591,000
Bankers' acceptances payable	(290,000)	(5,100,000)
Accounts payable	(581,000)	164,000
Accrued liabilities	(756,000)	(197,000)
Income taxes	(1,256,000)	(79,000)
Increase in working capital	$ 540,000	$ 438,000

The accompanying notes are an integral part of the financial statements.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

The major accounting policies of Allied Farm Equipment, Inc. (Company) and its subsidiaries are outlined below.

A. Principles of Consolidation

The consolidated financial statements include the accounts of all subsidiaries (all wholly-owned).

The financial statements of the Canadian subsidiaries have been translated into United States dollars as follows: current assets and current liabilities at the rate of exchange in effect at the close of the periods; long-term assets at the rates in effect at the dates these assets were acquired; long-term liabilities at the rates in effect at the dates these obligations were incurred; revenue and expense accounts at average exchange rates which were in effect during the years, except for depreciation and amortization which are at the rates of exchange in effect when the respective assets were acquired. Exchange adjustments are charged or credited to income.

In October 1975 the Financial Accounting Standards Board adopted Statement of Financial Accounting Standards No. 8. This Statement will require the Company to alter its methods of translating financial statements of its Canadian operations. The Statement must be adhered to no later than the Company's fiscal year beginning November 1, 1976 and provides for restatement of prior period financial statements.

The Company has not adopted this Statement for the fiscal year ended October 31, 1975. The effect on the financial statements, had the Company adopted the Statement for fiscal 1975, would have been to reduce net earnings for the fiscal year ended October 31, 1975 by $90,000 and reduce retained earnings by approximately $300,000. There would be no effect on net earnings for the fiscal year ended October 31, 1974.

B. Inventories

Inventories are valued at the lower of cost or market under the first-in, first-out method.

C. Property, Plant and Equipment and Depreciation

Depreciation of property, plant and equipment is principally on the straight-line basis using various rates based on useful lives. Expenditures for maintenance and repairs are charged currently to operations. In general, replacements and betterments are charged to the respective property accounts.

Gains or losses resulting from dispositions of property are included in current operations, except for gains or losses on Canadian Companies' dispositions which are either included in current income, or for assets handled on the composite basis, credited or charged to the accumulated depreciation account.

D. Income Taxes

Deferred income taxes (Canadian) are provided for the estimated income tax effect of timing differences between financial and taxable income. These timing differences relate primarily to the use of accelerated depreciation for income tax purposes. The allowable investment credit, when applicable, will be applied as a current reduction of income tax expense.

At October 31, 1975 undistributed earnings of subsidiaries that have been, or are currently intended to be permanently re-invested, amounted to approximately $4,818,000, for which no tax has been provided.

2. Foreign Operations

At October 31, 1975 Canadian subsidiaries had net assets of $5,576,000 and working capital of $5,679,000 and sales of $27,165,000 and net income of $651,000 for the year then ended.

Net unrealized foreign currency exchange gains (losses) amounting to approximately ($232,000) and $111,000 for the years ended October 31, 1975 and 1974, respectively, and realized gains (losses) from fluctuations in exchange rates during the years of approximately ($184,000) and $185,000, respectively, are charged or credited to cost of sales.

3. Notes Payable, Bank

The Company and its United States subsidiary have, under an Accounts Receivable and Inventory Loan Agreement, a line of credit of $7,500,000 with interest rates at 2½% over the prime rate (7¾% at October 31, 1975) for accounts receivable loans and at 3% over the prime rate for inventory loans. At October 31, 1975, $4,579,000 was outstanding under this agreement. The average borrowings outstanding during the period were $5,682,000 ($3,131,000 in 1974), at a weighted average interest rate of 11% (14% in 1974) computed by relating interest expense charged to monthly outstanding borrowings.

The Company's Canadian subsidiaries have lines of credit with a Canadian bank totaling $7,860,000 of which $6,390,000 was outstanding as of October 31, 1975. Of this amount, $1,000,000 is a non-revolving term loan payable November 1, 1976, with interest at 2% over the prime rate and is included in long-term debt at October 31, 1975, and $5,390,000 of this amount is bankers' acceptances payable in Canadian currency with interest rates at the prevailing market rate at the time of issue plus a commission to the bank of ¾ of 1% per annum.

The average borrowings outstanding during the period were $5,802,000 ($3,650,000 in 1974), at a weighted average interest rate of 8% (11% in 1974) computed by relating interest expense charged to the monthly outstanding borrowings.

The maximum short-term borrowings at any month end during fiscal 1975 under these agreements aggregated $7,317,000 ($5,344,000 in 1974) and $6,790,000 ($5,200,000 in 1974), respectively, for the United States and Canadian loans. Unused domestic and foreign bank lines of credit at October 31, 1975 approximate $4,391,000. Compensating balances are not required under these agreements.

At October 31, 1975, all accounts receivable and inventories of the Company and its subsidiaries were pledged as collateral under the Canadian lines of credit and United States inventory and accounts receivable agreement.

Also see Note 5 for certain subordinated security interests in accounts receivable and inventories.

4. United States and Canadian Income Taxes

Total tax provision for 1975 and 1974 resulted in effective tax rates different than the statutory federal income tax rate of 48%. The reasons for this difference are:

	Percent of Pretax Income	
	1975	1974
Statutory rate	48.0%	48.0%
Unrealized loss (gain) not deductible (taxable)	3.5	(2.5)
Canadian tax rate differences	2.4	
Other items	(1.2)	.9
Effective rate	52.7%	46.4%

5. Long-Term Debt

Long-term debt consists of:

	Portion Due Within One Year	Portion Due Beyond One Year
6% Convertible Subordinated Debentures due March 1, 1980	$ 80,000	$ 500,000
Term loans	188,000	734,000
Purchase contracts	561,000	580,000
Mortgages:		
6¾% due May 31, 1983	4,000	29,000
10¾% due December 31, 1994	4,000	485,000
Bank term loan due November 1, 1976 (see Note 4)		1,000,000
	$837,000	$3,328,000

6% Convertible Subordinated Debentures

The Debentures are convertible at any time into Class A common stock of the Company at $6.86 per share. They are redeemable, in total or in part, at the option of the Company, at par. The Indenture requires retirement of the Debentures at par plus accrued interest through a Sinking Fund in the principal amount of $100,000 in each of the years 1976 through 1979 and $200,000 at maturity. Sinking Fund payments may, at the option of the Company, be made in principal value of Debentures rather than cash. At October 31, 1975, the Company held Debentures in the principal amount of $20,000 to apply against the future Sinking Fund requirement.

The Debentures are subordinated to senior indebtedness (as defined in the Indenture) of $13,550,000 at October 31, 1975.

Term Loans

The term loans bear interest at 6¾% and 6⅞% and require annual principal payments of $190,000 (Canadian) through 1980. The loans may be prepaid in whole or in part, in any multiple of $50,000 with a prepayment penalty which ranges from 4¼% in 1975 to 2% in 1979.

Purchase Contracts

The purchase contracts evidenced by two notes payable arose in connection with the acquisition of businesses in 1968. One of the notes bears interest at 7% and is payable in annual installments of $21,000 through 1978.

The other note bears interest at 6¾% and requires annual payments of $540,000 in 1975 and thereafter through 1977. In the event the principal payment on this note in any year is less than 25% of the scheduled payment or if the aggregate of principal payments in any two consecutive years is less than 70% of scheduled payments for such years, the entire principal balance becomes due. If the principal payment in any year is less than 50%, or the aggregate of principal payments in any two consecutive years is less than 75% of the aggregate scheduled payments for such years, the holder may require certain shareholders (presently holding a majority of the shares) of the Company to elect such designees of the holder as may be necessary to elect a majority of the Board of Directors of the Company. Under restrictive provisions of the term loans above, principal payments to this holder are limited to 50% of the consolidated net earnings of the Company after October 31, 1970.

The Company also has outstanding warrants to purchase 110,277 shares of the Class A common stock of the Company in connection with the acquisition of one of the businesses. The Warrants may be exercised at a price of $3.00 per share, in whole or in part, until one year after the entire principal amount of the notes has been paid, but not later than August 31, 1983. The Warrants may be exercised by payment of cash or by cancellation at par of principal amounts due under the notes (allocated in proportion to principal amounts of scheduled payments).

Under the most restrictive terms of the debt agreements, the Company and its subsidiaries are required among other things to:

(i) maintain consolidated net working capital of at least $6,000,000 and a current ratio of at least 1.30 to 1.

(ii) maintain consolidated tangible net worth, as defined, of at least $2,150,000.

(iii) maintain accounts receivable and inventory of at least 175% of all bank, finance company and certain term debt collateralized by such accounts receivable and inventory.

(iv) restrict borrowings from banks on accounts receivable and inventories pledged to amounts which shall not exceed 110% of accounts receivable.

(v) limit the payment of dividends on common stock (other than stock dividends) and any other distribution on its common shares to 50% of the consolidated net earnings of the Company after October 31, 1970. Retailed earnings of $4,725,000 are restricted under this provision.

(vi) limit indebtedness to the parent company from its Canadian subsidiaries to an amount not to exceed $3,000,000 after February 15, 1971 and limit its direct investment in such subsidiaries to the amount held as of June 30, 1970.

At October 31, 1975 all of the above requirements were complied with.

Substantially all of the assets of the Company and its subsidiaries are pledged as collateral for debt.

The approximate aggregate amount of maturities and sinking fund requirements of long-term debt for each of the next five years is as follows: 1976, $837,000; 1977, $1,852,000; 1978, $314,000; 1979, $294,000; 1980, $395,000.

6. Pension and Profit Sharing Plans

In January, 1974, the Company established a contributory pension plan covering substantially all of its employees in the United States. Pension costs amounted to $45,000 and $21,000 for fiscal 1975 and 1974, respectively, and are determined under an aggregate actuarial cost method which includes recognition of past service cost. It is the policy of the Company to fund pension costs accrued. The actuarially computed value of vested benefits for the plan do not exceed the total of the pension fund and balance sheet accruals.

In addition, the Canadian subsidiaries have Deferred Profit Sharing Plans for substantially all employees. The plans are essentially similar and provide for contributions by each employer, of not less than 1% but not more than 20% of the aggregate earnings of all active participants during the fiscal year or the maximum allowed as a deduction from income under the Income Tax Act. Contributions are not required in a fiscal year in which a loss is incurred. The subsidiaries contributed $72,000 and $45,000 to these plans for fiscal 1975 and 1974, respectively.

7. Shareholders' Equity

The shares of Preferred Stock are of equal rank, and are identical, except for conversion privileges. The outstanding shares of Preferred Stock may be redeemed, in whole or in part, at the option of the Company by a vote of the Board of Directors, at any time from and after August 31, 1976 at a price per share equal to 105% of the par value per share thereof, plus unpaid cumulative dividends. Preferential liquidating rights are $100 per share plus unpaid cumulative dividends. The Series A Preferred Stock may be converted into Common Stock at $3.00 per share to November 1, 1976, and $2.00 per share thereafter. The Series B Preferred Stock may be converted into Common Stock at $2.00 per share after November 1, 1978.

During fiscal 1974, the Company agreed to offer to redeem, at par, 2,500 shares of Preferred Stock on November 1, 1976 and on each November 1 thereafter until November 1, 1981.

Dividends may not be paid on Common Stock until all dividends on Preferred Stock have been paid. Also, see Note 5 relative to restrictions of cash dividends on Common Stock. All dividends due on the Preferred Stock have been paid as of October 31, 1975.

During fiscal 1975 the Company adopted a new stock option plan for key employees (100,000 shares of Common Stock reserved) designed to replace the old plan which expired on February 4, 1975. As with the old plan, the option price may not be less than the fair market value at the date of grant; options may be exercised in installments of 25 percent of the shares during each of the second through the fifth year after date of grant on a cumulative basis. During 1975, 500 shares were exercised under the old plan. At October 31, 1975 options for 68,750 shares (presently exercisable as to 23,642 shares) had been granted under both plans. No charges are made to income in connection with the granting or exercising of stock options. At October 31, 1975 and 1974, 70,750 (new plan) and 312 (old plan, which expired) shares, respectively, were available for granting of options.

In 1975 outstanding common stock increased by 500 shares due to the exercise of stock options. There was no change in outstanding shares of common stock in 1974.

Changes during the year ended October 31, 1975 in options outstanding are summarized as follows:

	Number of Shares	Option Price Range
Outstanding, October 31, 1974	48,550	$1.00-3.25
Granted	29,250	3.38
Exercised	(500)	1.00
Canceled and expired	(8,550)	1.00-3.25
	68,750	1.00-3.38

Unissued common stock reserved is summarized as follows:

Stock options for employees	139,500
For conversion of 6% Convertible Subordinated Debentures	84,592
Stock warrants under Note Agreement	110,277
For conversion of 5½% Convertible Preferred Stock	750,000
	1,084,369

8. Rental Expense and Commitments

The Company has various leases for property which generally require payment of specified amounts which are subject to additional amounts for taxes, insurance and other operating expenses.

Total rental expense in 1975 and 1974 was $341,000 and $313,000, respectively.

Aggregate minimum commitments under all noncancellable leases as of October 31, 1975 are payable as follows:

Years	Rental Commitments
1976	$274,000
1977	220,000
1978	184,000
1979	129,000
1980	125,000
1981-1985	382,000
1986-1990	330,000
1991-1995	275,000

Of the total for all leases, $1,867,000 is applicable to land and buildings and the balance to equipment.

During fiscal 1975, the Company entered into an agreement to sell land and buildings, purchased during fiscal 1974, to a third party for its cost of $600,000 and to lease the property back for a period of twenty years from March 1, 1975 at a monthly rental of $5,500. The annual payments of this non-capitalized financing lease are included in the summary of rental commitments above. The present value of this non-capitalized financing lease and the effect upon net earnings if this lease were capitalized are not material.

Some of the Company's subsidiaries are required to take back equipment and repurchase accounts receivable under a financing arrangement in the event that its customers have failed to sell the equipment and remit the proceeds by the maturity date of the related receivables. Unpaid invoices subject to these terms amounted to $2,655,000 at October 31, 1975.

9. Extraordinary Items

Extraordinary items consist of:	1974
a) Nontaxable settlement received on cancellation of Canadian land lease	$ 63,000
b) Income tax benefit arising from utilization of prior years' operating losses	332,000
c) Utilization of non-resident withholding tax credits previously not allowable as a tax credit	235,000
	$630,000

10. Earnings Per Share

Earnings per common and common equivalent shares were computed on the weighted average number of common and common equivalent shares outstanding during each year. In computing average common and common equivalent shares outstanding, appropriate consideration was given to shares reserved for issuance upon exercise of options and warrants. Earnings per common share assuming full dilution was computed based on the assumption that the Series A and Series B preferred shares were converted at the beginning of the year thereby eliminating the preferred dividend requirement and the conversion of the 6% Convertible Subordinated Debentures.

11. Events Subsequent to the Balance Sheet Date:

On January 23, 1976, the Company repurchased 5,000 shares of Series "B" and 2,500 shares of Series "A" 5½% Cumulative Preferred stock for $750,000. In connection with this transaction a payment of $541,000, which was made on September 1, 1975 on an existing 6¾% Purchase Contract (See Note 5) was extended and deferred. This payment was treated as a reduction of debt at October 31, 1975 pending completion of the Stock Repurchase Agreement. The amounts due under the extension and deferral are $70,000 payable on September 1, 1976 and 1977 and $401,000 payable on September 1, 1978.

In addition certain consents were obtained from the term loan lender for the above repurchase. A condition of the consent was to accelerate partial payment of the existing term loan by an additional $24,000 annually February 1, 1976 through February 1, 1979.

The Company also agreed to offer to redeem, at par, 2,500 shares of Series "A" Preferred Stock on November 1, 1976 and on each November 1, thereafter through November 1, 1978.

The pro forma balance sheet reflects the above transaction as if it had occurred October 31, 1975. Pro forma earnings per common share assuming full dilution would have been $.98 per share for the fiscal year.

Officers:

James I. Kanter, President
Alexander J. Kanter, Vice President & Treasurer
Solomon Kanter, Vice President
Samuel M. Kane, Secretary
J. J. Jeffers, Vice President—Manufacturing & Marketing Sevices
Carl E. McNair, Vice President—Distribution
Daniel Z. Tropp, Vice President—Finance
Ray E. Porter, Controller, Assistant Secretary, Assistant Treasurer

Directors:

Alexander J. Kanter
James I. Kanter
Russell Baker, Senior Partner, Baker & McKenzie, Chicago attorneys at law
Robert D. Kelly, Vice President, A.T. Kearney & Co., Chicago management consultants
Ronald H. Shiftan, Corporate Finance Officer, Bear, Stearns & Co., New York investment bankers
Theodore H. Pincus, President The Financial Relations Board, Inc. financial relations consultants
D. W. Samman, Assistant to the President Allied Farm Equipment, Inc.

Certified Public Accountants:

Coopers & Lybrand
222 S. Riverside Plaza
Chicago, Ill.

General Counsel:

Baker & McKenzie
Prudential Plaza
Chicago, Ill.

Special Counsel:

Kane and Kane
10 S. La Salle Street
Chicago, Ill.

Transfer Agents:

The First National Bank of Chicago
Montreal Trust Company (Winnipeg Branch)

Trustees:

(Debentures)
The American National Bank and Trust Co. of Chicago

ALLIED FARM EQUIPMENT, INC.

ALLIED FARM EQUIPMENT
UNITED STATES:

Corporate Office: 35 E. Wacker Dr.
Chicago, Illinois 60601

Allied Farm Equipment, Inc. (Illinois)

Western Division—
R. E. Blinn, Gen. Mgr.
Belvidere, Illinois

Branches:
Eagan, Minnesota
Springfield, Illinois
Indianapolis, Indiana
Stockton, California

Allied Farm Equipment, Inc. (Delaware)

Eastern Division—
Charles Baker, Gen. Mgr.
Youngstown, Ohio

Branches:
Columbus, Ohio
Syracuse, New York

CANADA:

Allied Farm Equipment (Ontario) Ltd.

Eastern Canada Division—
William H. Cockshutt, Gen. Mgr.
St. Marys, Ontario

Branch:
Pointe Claire, Quebec

Allied Farm Equipment (Manitoba) Ltd.

Manitoba-Saskatchewan Division
I. L. Wood, Gen. Mgr.
St. Boniface, Manitoba

Winnipeg Manufacturing Division—
John L. S. Ross, Gen. Mgr.
St. Boniface, Manitoba

Branches:
Regina, Saskatchewan
Saskatoon, Saskatchewan

Allied Farm Equipment (ALTA) Ltd.

Alberta & British Columbia Division—
J. R. Findlater, Gen. Mgr.
Calgary, Alberta

Branches:
Edmonton, Alberta
Richmond, British Columbia